

Internal Revenue Service

Number: **201404007**

Release Date: 1/24/2014

Index Number: 7701.25-04

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B07

PLR-121580-13

Date:

September 19, 2013

LEGEND

Parent =

Corporation =

Taxpayer =

Name =

Trust =

Company =

State A =

State B =

Agreement =

X =

Y =

Dear _____ :

This letter responds to your letter dated May 6, 2013, and subsequent submissions, requesting a private letter ruling under § 7701(h) of the Internal Revenue Code.

FACTS

Parent is a State A corporation. Parent is the common parent of an affiliated group of corporations (the “Affiliated Group”), which files a consolidated federal income tax return on a calendar year basis.

Corporation is a State B corporation. Corporation is a direct, wholly owned subsidiary of Parent and a member of the Affiliated Group.

Taxpayer, doing business as Name, is a State B corporation. Taxpayer is a member of the Affiliated Group. Corporation owns 100% of the outstanding shares of Taxpayer.

Trust is a State B trust. Taxpayer is the settlor and sole initial beneficiary of Trust. For federal income tax purposes, the Affiliated Group treats Trust as a disregarded entity, the assets of which are owned by Taxpayer.

Company is a State B limited liability company and wholly owned subsidiary of Taxpayer. For federal income tax purposes, the Affiliated Group treats Company as a disregarded entity whose assets and activities are held directly by Taxpayer.

Each entity listed above uses the calendar year accounting period and the accrual method of accounting for maintaining its accounting books and records and filing its federal income tax return.

Taxpayer leases or manages a large number of motor vehicles in the United States, which are used by Taxpayer’s customers in their sales, services, or delivery operations. Taxpayer also provides fleet management services to its customers, including title and registration, fuel management, maintenance management and fleet administrative services.

Each approved customer that leases a motor vehicle from Taxpayer executes a lease agreement (the “Agreement”), which sets forth the general terms and conditions of the lease. Taxpayer executes the Agreement on its own behalf and as servicing agent for Trust. In most cases, the customer also executes one or more schedules

("Schedule"), which establish formulas for determining monthly rentals and other terms for those vehicles subject to the particular Schedule. Neither the Agreement nor the Schedule identifies the specific vehicles being leased. To lease vehicles, the customer must issue one or more non-cancelable orders ("Order") describing the vehicles that the customer desires to lease under the Agreement and the applicable Schedule. Vehicles acquired pursuant to an Order are incorporated into the Agreement through a Contract exhibit ("Exhibit"), which identifies the specific lessor for each vehicle ordered by the customer. (The Agreement together with its Exhibits, the Schedules, and Orders are collectively herein referred to as the "Lease Agreement.")

When a customer issues an Order to Taxpayer, Taxpayer (acting either on its own behalf or as agent for Trust) will issue a purchase order to the supplier of the titled motor vehicle. Subject to satisfaction of the conditions set forth in the purchase order, Taxpayer (for itself or as agent for Trust) will pay the manufacturer or dealer for the titled motor vehicle. When acquiring motor vehicles as agent for Trust, Taxpayer makes the payment directly to the manufacturer or dealer and creates an intercompany receivable from Trust under loan agreements between Taxpayer and Trust. In its capacity as servicer under a servicing agreement, Taxpayer applies all applicable payments received from the customer to pay down the intercompany receivable created at acquisition of the motor vehicle. Taxpayer finances all purchases of motor vehicles out of operating capital, capital contributions from Corporation, and the proceeds of fully recourse loans. Under the terms of the Lease Agreement, at the end of the motor vehicle lease term, the customer surrenders the motor vehicle and Taxpayer (acting either on its own behalf or as agent for Trust) solicits wholesale cash bids and sells the vehicle.

Most Agreements contain a terminal rental adjustment clause (or "TRAC"), which provides: (i) if the net proceeds from the sale of the vehicle exceed book value, the lessor retains an amount equal to the book value and remits the excess to the customer as a partial refund of rents paid, or (ii) if the net proceeds are less than the book value, the customer pays the lessor, as additional rent, the difference between the net proceeds and the book value. In most Lease Agreements, the lessor bears the risk when net proceeds are less than a guaranteed amount (generally, X percent of book value or, if the lease is terminated at the end of the minimum lease term, Y percent of the original cost of the vehicle).

When executing the Agreement, most customers sign and provide to the lessor a separate written statement (i) under which the customer certifies, under penalties of perjury, that it intends that motor vehicles leased under the Lease Agreement will be used more than 50% in the trade or business of customer and (ii) which states that customer has been advised that it will not be treated as the owner of the vehicles for federal income tax purposes (a "Business Use Certification.") (Each Lease Agreement

that includes a TRAC and a Business Use Certification is hereinafter referred to as a "TRAC Lease.")

In some cases, the Agreement includes a TRAC but the lessee does not execute a Business Use Certification. In those instances, Taxpayer and the lessee treat the lessee as the owner of the vehicle for federal income tax purposes and treat the arrangement between Taxpayer (or Trust) and the lessee as a loan for federal income tax purposes. Lease Agreements that do not include a Business Use Certification are not TRAC Leases and are not addressed in this ruling request.

Proposed Transaction.

Taxpayer intends to seek to use the receivables generated in its business to access cost-effective sources of funding by transferring the full beneficial ownership of leased motor vehicles to a special purpose entity, which will issue notes or other evidences of indebtedness secured by the receivables and the future cash flows they are expected to generate (a "Subsequent Refinancing").

Trust will issue a special unit of beneficial interest ("SUBI") to Taxpayer. Taxpayer will immediately transfer the SUBI to Company. In return for the SUBI, representing full beneficial ownership of the included leased motor vehicles, Taxpayer will receive cash or a combination of cash and equity interests in Company. The transfer to Company will be made pursuant to a Sale Agreement.

Company will transfer the SUBI to a wholly owned, special purpose subsidiary ("Issuer") pursuant to a purchase and sale agreement.

Issuer will be organized as a State B limited liability company. Like Company, Issuer will be a single-member entity that Taxpayer will treat as disregarded for federal income tax purposes under § 301.7701-3(b)(1)(ii) of the Income Tax Regulations. Because Issuer will be wholly owned by Company, which in turn is wholly owned by Taxpayer, for federal income tax purposes Taxpayer will treat the assets of Issuer as owned directly by Taxpayer. Accordingly, Taxpayer represents that the transfers of the SUBI by Taxpayer to Company and by Company to Issuer will be disregarded for federal income tax purposes.

In return for its transfer of the SUBI to Issuer, Company will receive an equity interest in Issuer and debt instruments ("Issuer Notes"). Company will transfer Issuer Notes outside of the Affiliated Group in exchange for cash.

Alternatively, Issuer may borrow directly from a bank or other third-party lender by issuing an Issuer Note in exchange for cash, in which case the consideration paid by Issuer to Company will take the form of an equity interest in Issuer and the cash proceeds from the loan to Issuer.

Taxpayer represents that in either event the Issuer Notes will constitute debt for income tax purposes and it will continue to be the tax owner of the underlying leased motor vehicles included in the SUBI. Thus, the issuance of the Issuer Notes outside of the Affiliated Group will not alter tax ownership of the motor vehicles.

Issuer will be a special purpose entity whose activities generally will be limited to: 1) executing and performing its obligations and exercising its rights under the terms of the Subsequent Refinancing and related transactions; 2) acquiring, transferring, financing, pledging, and otherwise dealing with the SUBI; 3) dealing with transactions involving the leased motor vehicles that will be designated to the SUBI; 4) borrowing money to the extent contemplated by the Subsequent Refinancing; 5) negotiating, executing, or performing the obligations under any agreement relating to the foregoing activities; and 6) engaging in any lawful act or activity and to exercise any powers permitted to limited liability companies organized under State B law that are related or incidental to and necessary, convenient, or advisable for the accomplishment of the foregoing purposes.

Issuer will enter into the Servicing Agreement and Administration Agreement with Corporation, which in turn will enter into a Subservicing Agreement with Taxpayer. As subservicer, Taxpayer will invoice the obligors, collect payments, and perform ancillary functions on behalf of Issuer.

Company will transfer the SUBI to Issuer. Issuer will use certain payments received on the leases represented by the SUBI to pay principal and interest on the Issuer Notes. Thus, as Taxpayer customers pay the underlying obligations to Issuer, Issuer will repay the Issuer Notes issued in the Subsequent Refinancing. Upon repayment of all the Issuer Notes, Issuer will distribute any remaining assets to Company and liquidate.

Taxpayer's business will continue to originate TRAC Leases and other assets. Taxpayer will identify assets originated by its business (including leased motor vehicles owned through Trust) that are eligible to be acquired by Company for inclusion in a future Subsequent Refinancing, based on criteria such as customer concentration, credit ratings, asset type and location, and the term of the lease. Further, Taxpayer, as the beneficiary of all of Trust's assets not assigned to a SUBI, may cause Trust to create new SUBIs. Taxpayer may transfer the new SUBIs to Company, which may use new Issuers to engage in future Subsequent Refinancings.

Trust is authorized to acquire cash, the leases and the related motor vehicles, to receive payments made under the leases, to sell or otherwise dispose of motor vehicles following the end of the leases, to hold motor vehicles certificates of title, and to own other rights and proceeds (collectively "Trust Assets").

When Trust acquires a motor vehicle, it holds legal title and the economic benefits and burdens of ownership (such as the right to rental income and the risk of loss). The SUBI represents all of Trust's ownership rights in the underlying leased motor vehicles with the exception of bare legal title, which Trust continues to hold for the benefit of the SUBI holder. The SUBI represents full economic ownership of particular vehicles assigned to that SUBI, but has no interest in, or exposure to, other assets and liabilities of Trust. In addition to the SUBI, Trust also has an undivided trust interest ("UTI") which represents a beneficial interest in all trust assets not assigned to a SUBI. Taxpayer is the holder of the UTI.

The UTI and the SUBI and their related assets constitute separate "Sub-trusts." The SUBI will represent beneficial interests in the portion of the Trust Assets that comprise its Sub-trust. Under State B law, all liabilities of a Sub-trust generally are enforceable only against the assets designated to the Sub-trust.

The owner of a SUBI has all of the incidents of ownership of the corresponding motor vehicles with the exception of bare legal title. As with any other trust, the trustee of Trust holds legal title as a fiduciary for the beneficial owner (in this case, the owner of the SUBI). Thus, the issuance of a SUBI permits the transfer of beneficial ownership of the associated assets without having to re-title the motor vehicles and prevents the need to qualify Issuer to do business in each jurisdiction in which vehicles are titled. Taxpayer represents that because the holder of a SUBI possesses the economic benefits and burdens associated with the underlying motor vehicles, the trustee's retention of bare legal title does not prevent tax ownership of the included motor vehicles from vesting in the holder of the SUBI.

RULINGS REQUESTED

Taxpayer requests rulings that the Lease Agreement of each TRAC Lease is a qualified motor vehicle operating agreement under § 7701(h)(2); and that qualification of the Lease Agreement of each TRAC Lease as a lease for federal income tax purposes will be determined without regard to the TRAC provision of the Agreement.

LAW AND ANALYSIS

Section 7701(h)(1) provides that in the case of a "qualified motor vehicle operating agreement that contains a terminal rental adjustment clause," the agreement is treated as a lease if (but for such "terminal rental adjustment clause") the agreement would be treated as a lease for federal income tax purposes, and the lessee is not treated as the owner of the property subject to the agreement during the period the agreement is in effect.

Section 7701(h)(2)(A) defines a “qualified motor vehicle operating agreement” as any agreement with respect to a motor vehicle (including a trailer) that meets three requirements, which are set forth in subparagraphs (B), (C), and (D) of § 7701(h)(2).

First, § 7701(h)(2)(B) requires that, under the agreement, the sum of the amount the lessor is personally liable to repay, and the net fair market value of the lessor’s interest in any property pledged as security for property subject to the agreement, equals or exceeds all amounts borrowed to finance the acquisition of property subject to the agreement. Any property pledged that is property subject to the agreement or property directly or indirectly financed by indebtedness secured by property subject to the agreement is not taken into account.

Second, pursuant to § 7701(h)(2)(C), the agreement must contain a separate written statement signed by the lessee that the lessee certifies, under penalty of perjury, that it intends that more than 50 percent of the use of the property subject to the agreement is to be in a trade or business of the lessee, and that clearly and legibly states that the lessee has been advised that it would not be treated as the owner of the property subject to the agreement for federal income tax purposes.

Finally, § 7701(h)(2)(D) requires that the lessor must not know that the certification in § 7701(h)(2)(C) is false.

Taxpayer represents that, if analyzed without regard to the terminal rental adjustment clause, each TRAC Lease created under a Lease Agreement will qualify as a lease for federal income tax purposes.

Further, Taxpayer represents that any amount it borrows to fund the initial acquisition from the manufacturer or dealer of a motor vehicle that is subject to a TRAC Lease will be recourse debt that Taxpayer is personally liable to repay, and that it will fund the entire acquisition price of the motor vehicle using operating capital or the proceeds of recourse debt. Hence, Taxpayer will be fully at risk on the acquisition price of the motor vehicles from the time of initial acquisition of the vehicle. In addition, Taxpayer represents that each TRAC Lease created under a Lease Agreement will contain a Business Use Certification that satisfies the requirements of § 7701(h)(2)(C) and will meet the requirements of § 7701(h)(2)(D).

Based on the facts and representations made by Taxpayer, and provided that: (1) Issuer borrows funds from lenders on a recourse basis; and (2) amounts received in lease payments and from the disposition of motor vehicles (using rental defaults consistent with historical experience) are expected to be sufficient to satisfy all obligations to lenders, we conclude that the Lease Agreement of each TRAC Lease is a qualified motor vehicle operating agreement under § 7701(h)(2). In addition, qualification of the Lease Agreement of each new TRAC Lease as a lease for federal

income tax purposes will be determined without regard to the TRAC provision of the Agreement.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning: (1) whether the Lease Agreement is a true lease for federal income tax purposes; (2) a situation in which Issuer borrows funds from lenders on a nonrecourse basis; and (3) a situation in which the amounts received in lease payments and from the disposition of motor vehicles (using rental default consistent with historical experience) are not expected to be sufficient to satisfy all obligations to lenders.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the letter ruling. See section 11.04 of Rev. Proc. 2013-1, 2013-1 I.R.B. 1, 49. However, when the criteria in section 11.06 of Rev. Proc. 2013-1, 2013-1 I.R.B. 1, 50 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

WILLIE E. ARMSTRONG, JR.
Senior Technician Reviewer, Branch 7
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: